# THE PROCESS OF INTERNATIONALIZATION OF THE FIRM – A MULTICRITERIA DECISIONAL APPROACH

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## Abstract

Internationalization is a strategy of those companies which identify business opportunities in the international market to enable them to obtain competitive advantages over competitors and decide to extend their activities abroad. Firm internationalization can be achieved in different ways, from the simplest and least risky operations to the those leading to a total commitment of the company on foreign markets. The choice between forms of internationalization appears to be a complex decision that depends on the resources of the company, the goals and benefits achieved through this approach.

The relation between the degree of involvement of the enterprise abroad and the risk level of internationalization is linear upwards, resulting in the process of internationalization in the domain of development. Our study shows that presenting the advantages and disadvantages of the ways of internationalization for the company that wants to develop abroad, known as cost-benefit analysis, is inadequate. Its management will aim at achieving a hierarchy of the mentioned processes, their comparison based on criteria more or less objective.

The models analyzed in this study entitle us to assert that it does not exist a rigorous model, generally available for choosing the form of internationalization of the firm. Factors to be considered are quite numerous and difficult to quantify, their scores being established in a subjective manner. In addition, there is no correlated analysis of the factors mentioned in models, especially of the ones that characterize the firm with the specific ones of the economical and political environment of the domestic market.

**Key words**: cost-benefit analysis of the internationalization decision, internationalization, internationalization in the development process.Firm internationalization is a process by which it targets its activity towards the outside, from simple export to production operations abroad, in other words, an international development of its business .

Regarding the *mechanism of internationalization* of the firm, the available literature (7) refers to several approaches. First, there are different opinions in understanding the nature of the internationalization process, as an evolutionary process, on the one hand, or as an unpredictable, fortuitous process, on the other hand. Then, there are two distinct concepts linked to the evolutionary approach - apparently accepted by most authors – the linear and the cyclical types of development.

To detail, the supporters of the idea of linear evolution claim that all companies follow the same process of internationalization, following an a priori set sequences, without returning to the stages of development already completed. However, those promoting the cyclical evolution theory consider internationalization a process that goes through more complex sequences or phases, with fundamental renewals of the business strategy and of the organizational structures. In our view, this latter approach most accurately explains the mechanism of the company's internationalization process.

The sine qua non requirement of the process of internationalization is the company's decision to invest abroad. Firstly (2), the firm internationalization motivations can be identified, in terms of decision substantiation, in two categories: proactive and reactive.

Companies that decide to internationalize their activities taking into account the proactive reasons, decide such actions on their own initiative, their motivation being the desire to obtain a high profit, to take advantages of the technical and technological achievements abroad, the proprietary information in their possession relating to certain foreign markets, where they "found" government facilities, or to benefit from scale economies (unit cost reduction with the increase in production).

Unlike the proactive reasons, reactive reasons occur in response to changes and pressures from the environmental conditions. Of these, the pressure of national and international competition, market saturation, seasonality of production, surplus production capacity, access to raw materials and cheap labor force, are those to make a firm enter foreign markets.

Relating to this approach, we believe that companies that base their strategy of internationalization of their economic activity on proactive reasons demonstrate an offensive attitude in the sense that they "attack" the international market without being constrained by the pressures of the external environment, unlike those that base their actions on reactive reasons, adopting a defensive attitude, an strategy of "defense."

The experience of the companies extending their business to foreign markets facilitates the identification of several reasons for internationalization (5). Thus, when the domestic market is saturated due to the fact that the product or service begins to move downward on the curve of its life cycle, or, in other words, the product matures or enters the phase of decline, it is time for the firm to seek new markets beyond national boundaries, characterized by strong growth.

In other cases, the decision to internationalize business may be explained by the firm desire or need to counteract foreign competition, represented both by foreign companies operating on the international market in its field of activity, and by the penetration of these companies on the national market of the former company.

Also, opening the new markets in South-East Asia, Central and Eastern Europe and Latin America by getting rid of trade and financial barriers, and establishing favorable FDI rules, make the implantation in these areas more interesting. Moreover, most of these countries provide a favorable business climate also by increased political stability or by raising the population income.

The large size of the enterprise gives it the benefit of lower unit costs through the so-called scale savings. Under these conditions, insufficient domestic market for a big production – dimensioned in this way to achieve scale savings - is another reason for the company to decide to expand its marketing by conquering international markets.

In times of recession manifested in one or more of the countries where they operate, the company may opt to change the geographical destination of the business, looking for a stable and favorable environment for development. Such decisions have been made by the European multinational companies based in the United States during the U.S. recession of the 80s, by redirecting their activities to the growing markets of the Middle East.

In areas of activity where the work factor has a significant importance in the cost of the finished product, it is profitable for a company to internationalize production where labor is cheaper. Also, the access to advanced technologies and to sources of raw materials, the desire to increase the company prestige, the recovery of research and development costs, and , not least, increased profits are just as viable grounds for an enterprise to extend its activity on the international market.

Although the reasons of the national companies to decide their embedding into foreign markets are diverse, they often find themselves in a position to face restrictions, following their entry into an economic, political, social and cultural environment characteristic for the host country: political instability and unstable institutional framework in the countries of the implant, the external debt of the potential host country, tariff and non-tariff barriers embodied in the high customs duties on imports (for the protection of national industries), the requirement to adjust imported products to a number of default local parameters, bureaucracy in the import business, corruption and technological piracy, cultural differences.

All these factors are likely to induce a state of economic and political crisis in that economy. In addition, due to the negative impact on foreign investments in general, and especially on direct ones, it will become increasingly difficult and costly - especially in social terms - for that state to rehabilitate the market condition, so to make it attractive to the foreign capital.

Evaluation reports on political risk published by specialized agencies such as Business International's (BI) Country Assessment Service, BERI or Frost & Sullivan's World Political Risk Forecasts, offer the companies interested to invest abroad information on the level of present and / or planned risk in each country.

However, the provided information is often considered to be inappropriate because they reflect only the macro risk that affect all foreign firms willing to invest in a particular country, but not the micro-risk every society and industry is facing.

Therefore, companies must use additional methods of assessment political risks, as General Electric and Caterpillar, for example, requiring additional information from advisory councils having renowned experts from abroad, or Gulf Oil, which has its own office for political risk assessment, with experts in the field (6).

Related to organizational strategic management, the decision to invest abroad involves, sequentially, the diagnosis analysis made by the company (assessing its strengths and weaknesses), identifying opportunities and threats on the external market (external environment analysis ) and, as a final step, evaluating the benefits and costs generated by a local company penetration on the international market (1).

Companies that decide to develop their activities abroad may choose from several options. They will choose one or more forms of internationalization, depending on the available resources (material, human and financial), the barriers found in certain markets or sectors (resulting from the regulations of countries that restrict some types of implantation in their national markets, tariff or non-tariff barriers, monopolies, etc..), the nature of competition, product nature, size and market growth, etc..

The methods used by a company to enter international markets are differentiated by the degree of its involvement abroad, moving from export to direct ownership. At the same time, these approaches bring advantages and disadvantages. Experience has shown that a national organization has, in general, the following forms of internationalization of its business: export, counterpart, licensing, franchising, underproduction, joint ventures and direct ownership.

An enterprise has many possibilities for internationalization of its business, from the simplest and least risky operations to a total commitment of the company on foreign markets. In our opinion, the relationship between the degree of involvement of the enterprise abroad (in terms of financial, human, material resources and managerial knowledge and invested time) and the risk level of internationalization (in terms of profitability, risk of loss of investment through nationalization, etc.) is linear upwards, as shown in Fig 1. The result is a process of internationalization in development (1).

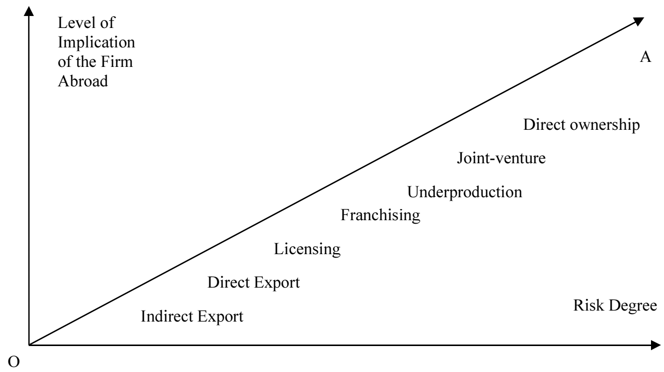


**Fig. 1:** The process of Internationalization in Development

In the figure, OA is rendered by an upward arrow, since the global trend is to increase the involvement of foreign firms in external operation, with the ultimate goal, the total implication by direct investments . We do not exclude the possibility that companies would go through only one or some of those phases, without fully involvement in the foreign markets. There are even times when companies call for different forms of internationalization of business simultaneously.

The slope of OA may be higher or lower depending on the ratio between the two variables. The development abroad by joint ventures, for example, can be done with a high risk, generated by the existing market conditions in the implantation country: risk of loss of control in favor of the local business partner , declining demand due to changes in consumer tastes, etc. In this case, the slope will be smaller. Going with the reasoning further, we find that, when the degree of risk varies from one to another way of internationalization - a fact often plausible and frequently met - the graph will take the form of a broken arrow: OA1A2A3A4A5A6 A7 (Fig. 2).

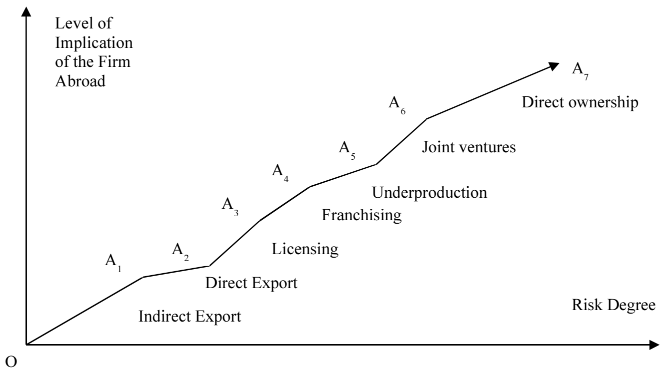


Fig. 2: The process of internationalization in the shape of a broken arrow

Presenting the advantages and disadvantages of the forms of internationalization for companies that want to develop themselves abroad is insufficient. Their management will want to be able to achieve a ranking of the mentioned processes, a their comparison based on criteria more or less objective. The analysis that we have undertaken in the previous pages should be understood in terms of choosing the form of internationalization, in the cost-benefit analysis. However, the variables to be compared are quite numerous and difficult to quantify, which makes it difficult for the manager to choose between different modes of business internationalization.

A method which facilitates the choice is considered to be the matrix analysis. That implies the representation in a table the forms of external development of the firm, and also the internal characteristics (strengths and weaknesses) and the external market characteristics (opportunities and threats), the latter being the foreign market in which the company is expanding its activity. To simplify, we considered only five types of internationalization: export, licensing, franchising, joint ventures and direct investment.

In each analysis a variety of factors are involved, with different influences (favorable and unfavorable) on the forms of internationalization. For the internal analysis the signs "+" indicate the strengths and "-" the weaknesses. In the external analysis, "+" indicates the opportunities, and "-" indicates the threats. For the final analysis "+" identifies the competitive advantage, and "-" the competitive disadvantage arising from opting for one or another of the presented methods. The latter analysis values are obtained according to the preponderance of the strengths or shortfalls of the first two tests.

Tab. 1: The Matrix Analysis for the foundation of the internationalization decision

| Analysis components | Type of influences | Forms of internationalization | | | | |
|---|---|---|---|---|---|---|
| | | Export | Licensing | Franchising | Joint-venture | Direct ownership |
| Internal analysis | + | | | | | |
| | - | | | | | |
| Foreign Market Analysis | + | | | | | |
| | - | | | | | |
| Final analysis for choosing the internationalization form | + | | | | | |
| | - | | | | | |

The internal analysis factors - which give rise to strengths or, on the contrary, to weak points for the firm, in terms of the mentioned choice - are: economic efficiency, resource requirements, experience and managerial and marketing expertise, type and characteristics of product or service, the number and complexity of post-sales services, manufacturing techniques and technologies, distribution channels, etc

The nature of competition, the number of consumers, the economic status, the political-legislative regime of the foreign market, the types of technologies used in the competition, are just some factors that may be taken into account when carrying out the external evaluation of the company. They, as also in the case of the diagnosis analysis, lead to positive or negative influences on the company in relation to the presented forms of internationalization.

Finally, adding pluses and minuses can give us fairly accurate information regarding the choice to take. However, for a more rigorous analysis, the positive and negative influences can be divided into three categories - low, medium, high - leading to more easily interpreted results. Another way of assessment is to assign a score on a numerical scale to the various influences and then to summarize these values.

Despite further details and the apparent simplicity regarding the determination of the final score, and thus the choice of the type of internationalization, it seems somewhat difficult to apply the matrix analysis method. This is because the criteria considered both for the internal and external analysis have a different importance for a company wishing to invest abroad, and some factors can have a greater "weight" in the analysis, in that they enhance the influence of other factors.

Therefore, we propose, for choosing the type of internationalization, another version of the matrix analysis , which takes into account the relative importance of each criterion, and which we call the weighted matrix analysis (1). It differs from the previous method in that we attribute the criteria or factors on which the analysis is based on weights determined subjectively. Also, we will not assess the ratio between the types of influences and the forms of internationalization with "+" and "-", but with scores or points from 1 to 10.

The method is not without fault, being governed by subjectivity: not only the relative importance of the analysis factors is determined subjectively, but also the score assigned to each factor. For example, a company may consider the nature of competition as the most important factor for deciding its internationalization, while another will assign greater importance to economic efficiency. Also, the first enterprise may grant a maximum score for the number and complexity of post-sales services factor, for the form of internationalization represented by the franchise, while the second firm, for export, depending on the impact of this factor on consumers in the host country. We can also note that the method does not have a general validity in the sense that it is not applicable to all firms simultaneously.

A more detailed analysis based on the form of internationalization, in the sense, that it takes into account a wider range of analysis factors, was developed by American economist Franklin Root. The analysis values the factors specific to the firm property and the factors specific to location, the latter being characteristic of the external markets targeted by the firm (4).

Even if the model is based on the work experience of the international companies, it suffers from inconsistency. We cannot compare the ways of entering a foreign market regardless of the company size and potential, on the one hand, and of the international market knowledge and experience, on the other hand.

At the same time, there is no correlation between these factors in the model, especially between the firm specific factors and the economic and political environment factors that characterize the foreign market. Thus, the choice does not follow any rule if, for example, the company has new technology but the policies of the origin country regarding investments are restrictive or trade policies of the destination country are restrictive. Finally, we cannot compare all forms of international business as applied to all companies (4).

The experience of the companies revealed a sequential and hierarchical approach to the forms of internationalization of business. According to it, in a first stage, firms choose from types of business involving direct investments and types of business which do not involve equity, depending on factors such as the characteristics of the host country and of the origin country, trade and political relations between the two countries and the factors of the industry in which the companies operate (4).

Despite the fact that it much simplifies the analysis, the method is finally reduced to a decision problem similar to that of the previous methods. Even if foreign markets penetration variants are less numerous, the methodological problems are largely the same. The methods mentioned above allow us to assert that a rigorous model does not exist, generally available for choosing the form of the internationalization of the firm. Factors to be considered are quite numerous and difficult to quantify, their scores being assigned in a subjective manner. In addition, there is no correlated analysis of the factors mentioned in the models, especially of the ones that characterize the firm, with the specific factors of the economical and political environment of the domestic market.

Moreover, even Dunning said in one of his works that “there is no single initial model to enter a foreign country. Much will depend on the characteristics of the target market, on how goods and services are produced and marketed, on the market structures in which the company competes and on the nature of the transaction mechanisms existing between countries. Literature suggests that the value and meaning of these variables will be strongly influenced by cultural, institutional, political and economic considerations specific for the respective country. Firm-specific factors, such as the firm’s technical capabilities in marketing, the experience on foreign markets, its potential interest in the new market, the knowledge of potential buyers and suppliers, are also relevant (3).

In conclusion, in our opinion, the choice should be based on cost-benefit analysis of each mode of entry into foreign markets, but not isolated, but in line with the specific internal factors, with those of the country of origin and of the foreign market, with those that characterize the industry. The analysis differs from one company to another, and so are the different factors taken into consideration. However, as a methodology for substantiation the decision of internationalization, the weighted matrix analysis is recommended, because it takes account the relative importance of each criterion in choosing the form of internationalization, valuing the internal and external factors, the advantages and weaknesses, the opportunities and the external dangers.

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